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Marta Rodríguez-Vives*

Towards a Common EU Debt: Where Do We Stand?

We are in a historical moment where Europe has reached a certain maturity in policy choices at the common level and has tested different policy instruments and interactions across countries. Without being an exhaustive list, the European Union and the euro area have experienced since the inception:

- common fiscal rules (the Stability and Growth Pact)
- the adaptation of state aid rules to crisis situations
- the resolution of several EU country crises during the sovereign debt crisis, with bilateral loans and supranational funding facilities (the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM))
- the start of the banking union (the Single Supervisory Mechanism and the Single Resolution Mechanism, although the European Deposit Insurance Scheme component is still missing)
- the implementation of unconventional monetary policy instruments, including what is often labelled “quantitative easing”.

The 2020-2021 pandemic crisis represented an inflexion point in supranational borrowing. With the European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) of up to €100 billion, and notably with the NextGenerationEU (NGEU) and its core component, the Recovery and Resilience Facility (RRF) of up to €723.8 billion, the EU has reached another milestone. Since 2020, the European Commission (EC), on behalf of the EU, began issuing EU debt on a large scale to fund these temporary programmes via grants and loans. These programmes were launched in addition to the long-term EU budget for 2021-2027 (€1,211 billion), which is funded via national contributions.

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This has several implications. First, it is the first time that the EC aims at providing a joint fiscal effort on a meaningful scale, thus complementing the ECB’s monetary response to the pandemic shock. Second, this makes the EC a major (temporary) issuer of government borrowing in euros worldwide. This brings the EC into a prominent place in the landscape of supranational euro debt issuers, together with the EFSF/ESM and the European Investment Bank (EIB).¹ The NGEU programme could lead to a new net borrowing activity above €700 billion by the end of 2026. Third, this initiative provides a substantial amount of burden sharing between countries. There is a solidarity element for the first time with a substantial grant component (direct transfers) in the equation that could serve as a catalyst towards a common fiscal capacity if successfully implemented.

With the latest economic and geopolitical developments, there is a renewed interest by policymakers and academic researchers in the possibility of joining forces to go beyond the national goods to European goods. Moreover, the EMU is still incomplete, and the idea of a permanent countercyclical fund for shock absorption is still being debated. There are many angles to be analysed about the possibility of creating a permanent common fiscal capacity, ranging from the legal aspects to the political economic arguments and moral hazard. Much of the past debate has focused on the role of fiscal rules and fiscal discipline and the compliance with the SGP. Either way, further integration would require additional funding. According to one view, a possible roadmap might include the continuation in some form of the NGEU project beyond its end in 2026, towards a more permanent central fiscal capacity. This may play a role in enhancing macroeconomic stabilisation and convergence in the euro area in the longer run. This view, however, is not reflected in the current policy agenda.

Against this backdrop, this article explores some aspects surrounding the idea of EU borrowing. It first focuses on the concept of EU debt and then elaborates on some related concepts, including considerations around the guarantees and feasibility of a common EU debt. Third,

¹ According to the European Court of Auditors (2023), the EC moved from the 15th largest debt issuers in the euro area in 2019 to 5th in 2021, only behind France, Germany, Italy and Spain. The EIB was 8th and the EFSF/ESM was 11th.

it points to some aspects relevant for the creation of a permanent common fiscal capacity, which would also entail the issuance of common EU debt. Finally, it then discusses what purposes could justify continued borrowing beyond 2026.

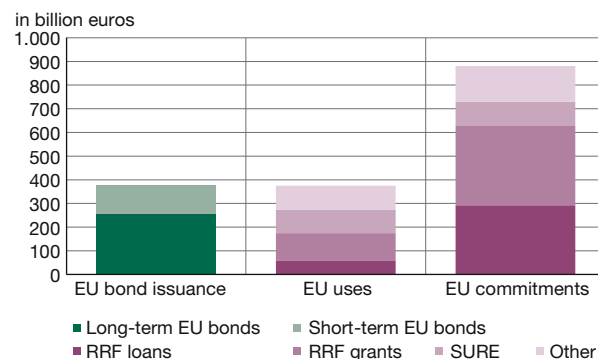
Common EU debt: Where do we stand?

The concept of common EU debt is an aggregated statistical construct obtained by adding the debt of individual member states. A key measure is the “Maastricht debt” (also known as EDP (Excessive Deficit Procedure) debt), which is the outstanding gross debt (defined as currency and deposits, loans and securities other than shares) at nominal value and consolidated between and within the sectors of general government (Lojsch et al., 2011). This covers the general government sector of the member states, intergovernmental lending and the EC as it possesses tax redistribution power and capacity to issue debt. The EC has been issuing bonds to support different EU policies for the last 40 years,² but it only became a prominent debt issuer as of 2020.

On 22 October 2023, Eurostat published the aggregated EU debt, which amounts to €16 trillion or 91% of GDP (the euro area debt amounts to around €13 trillion or 90.9% of GDP). This figure accounts for loans provided by the EFSF/ESM to the beneficiary member states (i.e. Ireland, Greece, Portugal, Cyprus and Spain) and the RRF loans once payments have been finalised. Borrowing in the markets undertaken by the EC to finance the RRF grants is also considered EU debt.³ However, the debt issuance associated with the past funding of the RRF grants is not reflected yet in the national and EU debt aggregates of 2021 and 2022, pending future Eurostat publications.

Focusing on the supranational new net borrowing activity from the EC, which is part of the EU debt, Figure 1 shows that around €375 billion have been raised from several new EU bond issuances over 2020-2023. This issuance activity compares with the €78 billion of new securities issued over 2009-2019. The EC has issued mostly long-term EU bonds (around 70%). The main uses of the common pool have been to finance SURE (€98.4 billion) and

Figure 1
EU debt by the European Commission, 2020-2026
New bond issuance and uses (2020-2023) and commitments (2020-2026)



Notes: The cut-off date is 09/11/2023. Other refers to the aggregation of estimated resources to fund other programmes, e.g. NGEU's non-RRF, MFA, MFA+, and EFSM.

Source: Author's elaboration based on data from the European Commission.

the RRF. The disbursement process is well on track as the member states are receiving their funds when requested. The disbursement proceeds from the RRF facility are directly transferred to the member states, while the non-RRF funds are transferred to the EU budget. The EC has already disbursed to EU member states around €174 billion, with around two-thirds of disbursements in the form of RRF grants. The main beneficiaries of the RRF funds by now are Italy (€85.4 billion), Spain (€37 billion), France (€12.5 billion) and Greece (€11.1 billion).

The NGEU programme (with a total envelope up to €806.8 billion, of which €723.8 billion constitutes the limit of the RRF) was designed with a RRF-grant element (up to €338 billion), a RRF-loan element (up to €385.8 billion) and a non-RRF element (€83.1 billion) to top-up other EU programmes (e. g. ReactEU). The actual amount of funds to be borrowed by the EC by 2026 for the RRF will depend on the final implementation of the Recovery and Resilience Plans (RRPs) by the member states. The most updated funding needs for the RRF are around €630 billion, after the call for requests for loans ended on 31 August 2023.⁴ This is in addition to the NGEU's €83 billion contribution from the non-RRF programme. The EC average annual expected funding needs are still at around €150 billion

2 The EC has issued bonds to finance, among others, the Macro-Financial Assistance (MFA) programme with loans for non-EU countries, the European Financial Stabilisation Mechanism (EFSM) to support EU countries under financial stress, Balance of Payments (BoP) assistance for non-euro area EU countries with BoP difficulties. Since 2023, there is the new MFA+ which includes concessional loans for Ukraine.

3 It must be noted that the debt issued by the ESM is now recorded in the EU debt (and not in the rest of the world sector (S.212) as before). The EIB and the European Investment Fund are, however, classified outside the EU debt: they are classified within the financial corporations sector (S.12).

4 Out of €385.8 billion available for RRF loans, 76% have been committed, which has brought the total RRF loan requests to almost €293 billion. This is also the final amount of RRF loan requests, as, based on Art. 14(2) of the RRF Regulation, the loan requests had to be made by 31 August 2023. As a result, out of a total RRF envelope of almost €724 billion, €631 billion (87.2%) have been already committed: €338 billion in grants and €293 billion in loans.

per year until 2026. The amount that will finally be issued by the EC, whether to be disbursed to the countries via grants or loans, will increase the stock of EU debt aggregate going forward.

The economic case for common EU debt

There are several economic aspects regarding the feasibility of common EU debt.

Figure 2 summarises the solvency aspects of the EU debt linked with the temporary NGEU programme. The EU Treaties allow the EC to borrow from capital markets on behalf of the EU. This implies that the EC borrowing represents direct and unconditional obligations of the EU to service its debt. The EU's debt service is further guaranteed by the loan agreement, as the beneficiary member states have always been able to service their debt. Regarding the future repayment of the grant component, there is still a lack of clarity of which common resources will be raised at the EU level. However, there is a direct guarantee from the EU budget, as the EU is the ultimate guarantor of the EU debt. Moreover, the governments have committed to providing an additional ceiling of up to 0.6% of their national resources (gross national income) if additional revenues are needed.⁵ This represents a contingent liability to the member states that ensures that the EU debt is viable. Overall, the borrowing activity of the EC is considered with a low risk of default.⁶

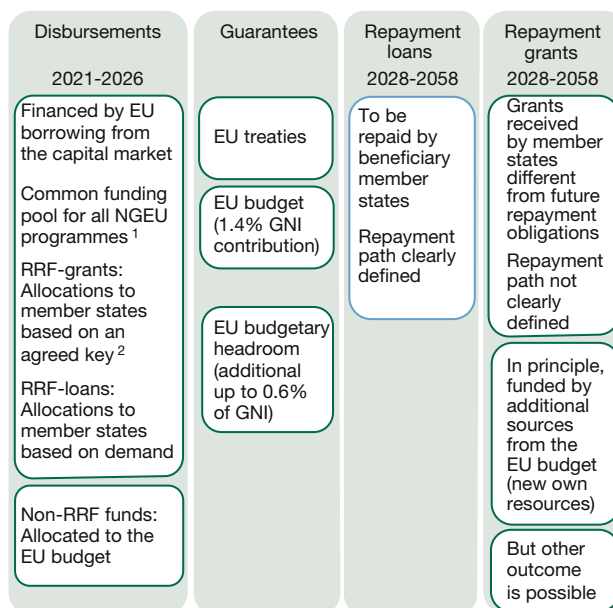
From an operational perspective, the EC moved from the back-to-back funding typically used to fund previous lending programmes to a new diversified funding strategy for the NGEU. The main difference is that it decouples the timing, volume and maturity of the borrowing transactions from the timing of the reimbursement of funds (European Court of Auditors, 2023). The rollover profile ensures a smooth repayment profile. Most of the debt to be issued will be long-term debt, and repayments (of debt and interest costs) are expected over 2028-2058. The final borrowing cost is unknown at the moment, but the prospects are good (e.g. Claeys et al., 2023), given some considerations: i) the cost of funding in the short term is increasing with the nominal interest rates, ii) the borrowing cost of

⁵ If there are difficulties in raising extra revenues during 2028-2030, when there is a peak of financing needs, then there might be a need to opt for additional avenues. Further options may include, for example, the reduction of other EU expenditures, the increase of national contributions (beyond the agreed limit of additional contributions up to 0.6% on GNI) or the reduction of the expenditure in the countries with high DSA risks.

⁶ The EU bonds have a high rating from the credit agencies, ranging from AAA (Fitch, Scope and DBRS)/Aaa (Moody's) to AA+ (S&P), all with outlook stable.

Figure 2

Key features of EU debt within the NGEU programme



Note: ¹ The common pool of funding is EU borrowing to fund NGEU (RRF and non-RRF programmes), SURE, EFSM, BoP assistance facility, MFA and Euratom. The actual amount of funds borrowed by the Commission for the NGEU will depend on the final implementation of the RRFs by the member states. ² Allocation key depending on change of real GDP in 2020 and 2020-2021, relative unemployment rate, population and reversed GDP per capita. The initial allocations of grants in 2021 have been slightly revised during 2022 based on the updated statistics for 2021.

Source: Author's elaboration based on publications from the European Commission and the European Court of Auditors.

the EU debt is still above that of Germany and France (but below that of Spain and Italy), and iii) the market liquidity of the EU bonds is not as high as, for instance, the German bonds. Some reasons might be linked to the defined duration of the EU bond issuance with a clear cut-off date by the end of 2026 and that investors may deter to include EU bonds in their long-term investment strategies (e.g. Bletzing et al., 2023).

The current debate centres around the concept of debt sustainability analysis (DSA) and the ongoing European governance reform package, which also tackles the government debt angle. One of the expected consequences of the RRF design is that by improving, *ceteris paribus*, growth prospects and lowering the cost of financing (implying some interest savings), the RRF will help to somewhat mitigate debt sustainability concerns in vulnerable countries and may provide more fiscal space for economic stabilisation in the future (Freier et al., 2021). In the countries with high debt-related risks, it is also key with

respect to reducing the stock of government debt through more favourable economic conditions and improved quality of public finances.

From the DSA perspective, country-specific concerns have improved in the highly indebted countries. The channels accounted for in the DSA are a combination of favourable risk premium effect, the impact of the fiscal stimulus on growth and inflation, and the effect of structural reforms on potential output. Overall, it is estimated to have the potential of reducing the government debt ratio by around 14 percentage points of GDP in Spain and 12 percentage points of GDP in Italy by 2031 (Bankowski et al., 2022). These favourable debt trajectories will depend on the future evolution of interest rates and on the timely and efficient implementation of the reforms and investment plans outlined in the RRP.

Towards a permanent common fiscal capacity: Allocation vs. stabilisation

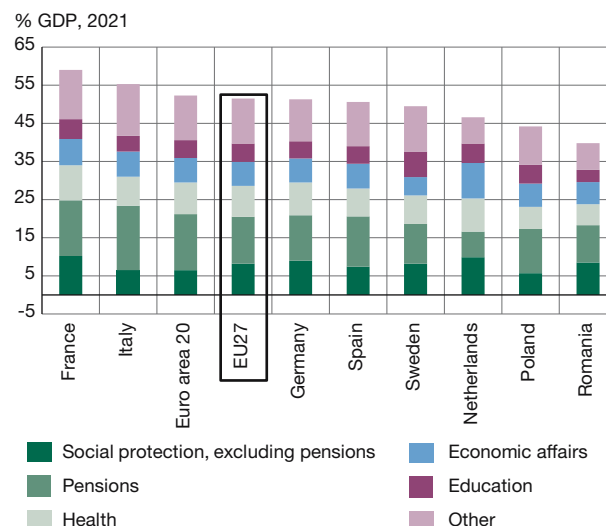
In brief, there are two main purposes for making the case for a permanent central fiscal capacity: allocation of resources and stabilisation of the economic cycle.

The temporary NGEU is a mix of both objectives, as its resources are mainly used to support structural reforms and the investment capacity towards the green and digital transitions (mainly via direct government investment and capital transfers to the private sector). The component of stabilisation comes from the possibility to respond counter-cyclically to an economic shock (e.g., the COVID-19 crisis or an energy shock). Moreover, the countries that were most hit, Italy and Spain, receive the most funds, pointing to an element of solidarity.

Currently, there is a discussion ongoing on the need for centralised financing of common EU investment needs (e.g. Panetta, 2023; Draghi, 2023). This could range from defence and migration to economic challenges such as ageing populations – with the associated costs in pensions and health care – or the centralisation of purchases of raw materials. A related concept is the European public goods (EPGs), that entails, among other features, both common EU financing and the joint production of goods (Buti et al., 2023). The experience of the NGEU shows that less than 5% of the investment projects are cross-national in nature: in other words, the projects funded by the EU are mostly nationally produced and, therefore, would not qualify for EPGs.

The key question is whether we could converge towards the provision of more common public goods. European governments spend, on average, the highest amounts of

Figure 3
Where do EU governments spend their national budgets?



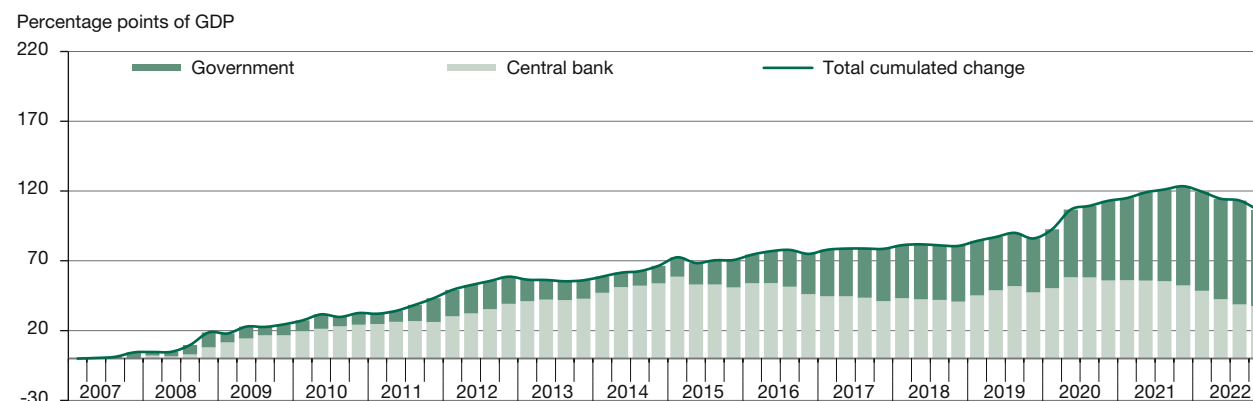
Notes: Other includes the remaining economic activities, namely general public services, military expenditure, public order and safety, environmental protection, housing and community amenities, and recreation, culture and religion.

Source: Author based on COFOG data (Eurostat).

funds in the world (in percentage of GDP) for the provision of public goods and services. Yet, there are different preferences and fiscal capacities. Figure 3 shows how the EU, the euro area and selected countries spent their budgets in different economic functions. The main function is redistribution, with social protection (including pensions) being the largest component of public expenditure in all countries, amounting to 21% of GDP on average. Pension payments represent around 60% of this expenditure on average. Other priorities (although with different national preferences) are health, economic affairs and education. In contrast, most of countries spent the lesser resources in defence (1.3% of GDP) and environmental protection (0.9%) in 2021. Some of these goods and services could be eventually brought at the European level, with the subsequent issuance of more common EU debt.

On the other hand, a permanent fiscal stabilisation capacity is still missing in the Economic and Monetary Union (EMU) architecture. The idea put forward by several researchers and commentators is to introduce a permanent counter-cyclical central capacity to respond in cases of economic country-specific shocks – or common shocks with asymmetric effects across countries – when national fiscal stabilisers are impaired or when countries face difficulties to

Figure 4

Increase of leverage in the euro area by contribution, governments and central bank, 2007-2022

Source: Girón and Rodríguez-Vives (forthcoming).

borrow on financial markets (e.g. Beetsma et al., 2021). This concept has been largely debated in academia and in European fora, with contributions from the macroeconomics and political economy literature. The discussions on the trade-offs of a permanent common fiscal capacity and its optimal size are beyond the scope of this paper, but some momentum might emerge in view of the recent developments. Regarding the potential moral hazard argument, a push factor would be the implementation of an improved fiscal governance framework in the EU as of 2024. Concerns over the possible generation of permanent transfers among countries, could be partly alleviated by the NGEU programme being a success story and by introducing safeguards in the design of the central fiscal capacity itself. For example, transfers – for each country – could be calibrated to deviations from historical growth, not on growth differences between countries (see, e.g. Beetsma et al., 2022). The non-repayable part (transfers) constitutes around half of the total envisaged NGEU envelope, which implies a step forward in cross-country risk sharing at the EU level. A possible permanent common fiscal capacity would likely be limited to euro area countries, instead of the EU. One of the main arguments is that euro area countries do not have the possibility to use their national currency to devalue in case of major economic shocks.

Finally, another related important angle is the role of the central banks as lenders of last resort, which is explained in Girón and Rodríguez-Vives (forthcoming). Figure 4 shows the combined leverage response in the euro area over 2007-2022. It is clear from the figure that the contribution of the Eurosystem to the combined euro area fiscal-monetary policy response (measured in leverage) has increased over time. The ECB has supported

the ability of national fiscal policies to stabilise the cycle beyond automatic stabilisers in the presence of increases in sovereign spreads.⁷

Conclusions

A precondition for thinking beyond the 2026 deadline for more EU common debt would be that the NGEU programme is perceived overall as successful from different perspectives, ranging from the operational borrowing performance to the materialisation of the macroeconomic expected impacts.

The effectiveness of the NGEU will crucially depend on a timely and effective implementation of the RRP. However, it is too early to assess the implementation. Implementation risks relate to possible lower-than-expected absorption capacities, with the substitution of productive investment expenditure with consumption/social expenditure, or the possibility that the investment targets are not fully met by 2026. A careful monitoring and implementation of the reporting and review mechanisms in place at the European and national level is key for the success of the NGEU project. The European Court of Auditors has been relatively positive in its initial assessment over the 2021-2022 implementation. In 2024, there will be an audit to assess the mid-term review of the programme, which will be key for public trust in this novel policy instrument.

⁷ For instance, the public sector purchase programme initiated in March 2015 implied the expansion of the asset purchase programme that started in 2014. See <https://www.ecb.europa.eu/mopo/implementation/app/html/index.en.html>.

In view of the current developments, choices on how to better allocate public resources are becoming even more crucial. New economic and geopolitical challenges are impacting national and EU budgets (e.g. digitalisation trends, climate change, deglobalisation trends, defence expenditure, war in Ukraine), while several countries face increasing challenges (e.g. immigration, energy supply costs, high stock of debt, ageing populations). Looking ahead, the urgency of further sharing the public goods and burdens across EU countries may increase. Moreover, the higher frequency of economic shocks may justify the room for a permanent joint rainy fund and accelerate the process of completing the EMU.

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